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No. 90-1881

In the Supreme Court of the United States

OCTOBER TERM, 1991

FRANKLIN FEDERAL SAVINGS BANK, ET AL., PETITIONERS

v.

DIRECTOR, OFFICE OF THRIFT SUPERVISION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, which imposes new capital requirements on savings and loan institutions and restricts their ability to use "supervisory goodwill" to meet those requirements, supersedes an earlier "regulatory forbearance" granted by the now defunct Federal Home Loan Bank Board concerning the use of such goodwill.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-27a) is reported at 927 F.2d 1332. The decision of the district court (Pet. App. 28a-31a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on March 12, 1991. The petition for a writ of certiorari was filed on June 7, 1991. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Morristown Federal Savings and Loan Association suffered financial losses from 1983 to 1988. In the

mid-1980s, investors formed a holding company, Franklin Financial Group, Inc., to acquire Morristown upon its conversion from the mutual to the stock form of ownership. In accounting for the transaction on its books, the conversion plan called for the new institution (to be named Franklin Federal Savings Bank) to treat Morristown's negative net worth as an intangible asset called "supervisory goodwill," to be amortized over a period of time. Pet. App. 3a-4a.

The Federal Savings and Loan Insurance Corporation (FSLIC) and the Federal Home Loan Bank Board (Bank Board) approved the transaction in late 1988. In connection with that approval, the Bank Board issued a "forbearance letter" granting Franklin's request for permission to amortize certain intangible assets, including supervisory goodwill, for a period not to exceed 25 years. See Pet. App. 5a, 32a-33a. In January 1989, Franklin and FSLIC executed a Voting and Disposition Rights/Dividend Agreement, containing the terms of the approved transaction. Section VIII(D) of the agreement states:

> All references to regulations of the [Bank] Board or the FSLIC used in this Agreement shall include any successor regulation thereto, it being expressly understood that subsequent amendments to such regulations may be made and that such amendments may increase or decrease Acquiror's obligation under this Agreement.

Pet. App. 5a (emphasis omitted).

2. On August 9, 1989, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183 (codified in part in scattered sections of 12 U.S.C.). FIRREA addresses the severe crisis throughout the thrift industry that was occasioned, in large measure,

by the significant undercapitalization of many savings institutions. H.R. Rep. No. 54, 101st Cong., 1st Sess. Pt. 1, at 310 (1989) [hereinafter *House Report*]. In addition to providing massive public funding to bolster the thrift industry and to restore public confidence, FIRREA was intended to prevent a recurrence of past financial abuses and poor financial practices. *Id.* at 307-308.

FIRREA abolished both FSLIC and the Bank Board and transferred their functions to a new insurance fund under the Federal Deposit Insurance Corporation (FDIC) and the newly created Office of Thrift Supervision (OTS) within the Department of the Treasury. FIRREA § 401(a) and (h), 103 Stat. 354, 357; see FIRREA §§ 201(b), 202, 103 Stat. 188. A key ingredient of the legislative reform is strengthened capital requirements. *House Report* 310-311, 322; 135 Cong. Rec. H2711 (daily ed. June 16, 1989) (Rep. Pelosi).

As pertinent here, Section 301 of FIRREA imposes three capital requirements on thrift institutions. "Core capital" is to coincide with "core capital" as defined by the Comptroller of the Currency for national banks, "less any unidentifiable intangible assets" and plus certain mortgage servicing rights, 12 U.S.C. 1464(t)(9)(A),[1] and is to be "not less than 3 percent of the savings association's total assets." 12 U.S.C. 1464(t)(2)(A). Core capital can include only limited amounts of supervisory goodwill, with the amount being gradually reduced to zero by January 1, 1995. 12 U.S.C. 1464(t)(3)(A). Moreover, supervisory goodwill included in core capital has to be amortized annually at a rate that would lead to full amortization in a

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[1] All references in this brief to provisions of Title 12 of the United States Code are to the United States Code (Supp. I 1989).

maximum of 20 years. See 12 U.S.C. 1464(t)(9)(B). "Tangible capital" is defined as "core capital minus any intangible assets," 12 U.S.C. 1464(t)(9)(C). Tangible capital thus excludes all supervisory goodwill, and is to be "not less than 1.5 percent of the savings association's total assets." 12 U.S.C. 1464(t)(2)(B). The "risk-based capital" requirement was to be defined by the Director of OTS so as not to "result in materially lower levels of capital being required of savings associations under the risk-based capital requirement than would be required under the risk-based capital standards applicable to national banks." 12 U.S.C. 1464(t)(2)(C). In Thrift Bulletin 38-2 (Jan. 9, 1990), OTS announced that it would apply the new capital standards to all savings institutions, including those that had previously been granted forbearances by the Bank Board.

Failure to comply with the new capital standards will result in the imposition of asset growth restrictions and may also result in the issuance of a capital directive limiting the use of thrift funds. 12 U.S.C. 1464(t)(6). It can also lead to the appointment of a conservator or receiver and provide cause to commence proceedings to terminate deposit insurance. *Id.* §§ 1464(d)(2), 1818(a). OTS, however, has authority to grant relief from most sanctions that could be imposed for failure to satisfy capital standards. *Id.* § 1464(t)(7).

3. Petitioners commenced this action, seeking a permanent injunction against enforcement of the capitalization provisions limiting use of supervisory goodwill. The court entered a restraining order against OTS and the FDIC and, after hearing evidence, granted the petitioners' request for a permanent injunction.

The district court found that the forbearance letter issued in connection with the approval of the conversion and sale of Morristown "was an integral part of the entire agreement and was for the benefit of all parties." Pet. App. 29a. It also concluded that FIRREA does not "abrogate" the grant of the forbearance, which it characterized as "binding" on OTS and the FDIC as successors to the Bank Board and FSLIC. *Id.* at 30a. In reaching that determination, the district court relied on Section 401(g)(1) of FIRREA, 103 Stat. 356-357, which states that the provision abolishing the Bank Board and FSLIC (§ 401(a), 103 Stat. 354) "shall not affect the validity of any right, duty, or obligation of the United States, the * * * Bank Board, or any other person, which * * * existed on the day before the date of the enactment of this Act." Pet. App. 30a. The court also recorded its belief that, in any event, the Bank Board's forbearance letter "expressly waived" any subsequent legislative changes. *Ibid.* The court thus permanently enjoined OTS and the FDIC "from excluding the amortization of supervisory goodwill from any and all determinations of [Franklin's] capitalization as set out in the [forbearance letter]." *Id.* at 30a-31a.

4. The Director of OTS and the FDIC appealed, and the court of appeals reversed. Pet. App. 1a-18a.[2] The

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[2] At the time petitioners filed this action, neither OTS nor the FDIC had initiated administrative action against petitioners in order to effect their compliance with the new capital standards. The court of appeals determined that, although it was "a close case" (Pet. App. 7a-8a), petitioners' claim against OTS was ripe for review inasmuch as Thrift Bulletin 38-2 amounted to an unequivocal and final statement of that agency's position, and Franklin would suffer sufficient harm without judicial review. Pet. App. 8a-11a. The court concluded otherwise as to the FDIC, however, because that agency had

court found that the capital requirements imposed by FIRREA conflict with those provided for in the earlier forbearance letter, particularly insofar as 12 U.S.C. 1464(t)(9)(B) requires amortization of supervisory goodwill within no more than 20 years, rather than the 25 allowed by the letter. Pet. App. 12a. The court, however, rejected petitioners' argument that Section 401(g)(1) of the Act nonetheless preserves the forbearance. Finding no support for the view that Section 401(g)(1) was meant to affect the scope of FIRREA's substantive requirements, the court held that "the plain language of the statute limits the reach of section 401(g)(1) to those obligations that could have been affected by virtue of the abolition of the FSLIC or the [Bank Board]." Pet. App. 14a. Since it was the substantive provisions of FIRREA imposing the new capital requirements—not the abolition of FSLIC and the Bank Board and transfer of their responsibilities to new agencies—that conflicted with the capital requirements in the forbearance letter, Section 401(g)(1) did not limit the application of the new capital requirements to petitioners. Pet. App. 14a. After finding added support for this conclusion in FIRREA's legislative history (Pet. App. 15a-17a), the court concluded that OTS's construction of the Act is reasonable and entitled to deference under *K Mart Corp.* v. *Cartier, Inc.*, 486 U.S. 281, 290-292 (1988), and *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-844 (1984). Pet. App. 17a.

The court of appeals found no need to decide whether the forbearance letter had the binding force of a contract, as petitioners had urged, or was instead a "mere statement of regulatory intent." Pet. App.

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taken no action against the petitioners. *Id.* at 11a-12a. Petitioners do not here challenge that ruling.

17a-18a. The court indicated, however, that if the forbearance letter were a contract, there was sufficient evidence to infer congressional intent to effect a taking, for which compensation, rather than equitable relief, would be the proper remedy. *Id.* at 18a.

Senior Circuit Judge Contie dissented. Pet. App. 18a-27a. In his view, Section 401(g)(1) of FIRREA "directly applies" to this case. Pet. App. 19a. He rejected the court's conclusion that that provision preserves only those rights, duties, and obligations that would otherwise be affected by the abolition of the FSLIC and Bank Board. Instead, he read the language of Section 401(g)(1) as mandating the government's observance of all obligations it incurred prior to the passage of the Act, unless explicitly abrogated by the statute. He found no such explicit congressional intent insofar as supervisory goodwill forbearances are concerned. Pet. App. 21a-22a. Judge Contie concluded that the forbearance involved here was a bargained-for, necessary component of the agreement between the Bank Board and Franklin, by which the government must abide. *Id.* at 26a-27a.

ARGUMENT

Although, as petitioners note (Pet. 9-11), a number of district courts have addressed the issue at hand with varying outcomes, the decision of the court of appeals in this case is correct and entirely consistent with that of the only other court of appeals to have reached the issue. Accordingly, further review is unwarranted.

1. In *Guaranty Financial Services, Inc.* v. *Ryan*, 928 F.2d 994 (1991), the Eleventh Circuit interpreted both 12 U.S.C. 1464(t)(3)(A) and Section 401(g)(1) exactly as did the court of appeals here. The Eleventh Circuit found 12 U.S.C. 1464(t)(3)(A) to be "unqualified" in

that "[i]t provides for no exceptions to the phase-out schedule it establishes" for the use of supervisory goodwill in calculating core capital. 928 F.2d at 1002. As for Section 401(g)(1), the *Guaranty* court concluded, as did the Sixth Circuit in this case, that by its terms that provision "is concerned only with the effect of subsection (a), which eliminates the Bank Board and the FSLIC." 928 F.2d at 1003. The Eleventh Circuit reasoned that "the possible loss of [the thrift's] supervisory goodwill forbearance is the result not of the abolition of the agencies, but of the new capital standards, and that a savings provision that says that the abolition of the agencies 'shall not affect the validity of any right, duty, or obligation' is inapplicable to [the thrift's] situation." *Ibid.* See also *id.* at 1004-1006 (concluding that legislative history shows that "Congress intended * * * to abrogate capital forbearances"). The court therefore held that the OTS interpretation of FIRREA was not only "permissible," but also "unambiguously support[ed]" by the legislative history. *Id.* at 1006.

As is often the case with new and complex legislation, the initial decisions of the district courts concerning FIRREA's mandated treatment of supervisory goodwill have varied in result. Until and unless there is a conflict in the decisions of the courts of appeals on this issue, however, further review of this issue is unwarranted.

2. The decision of the court of appeals is correct. The unmistakable intent of FIRREA was to resolve the crisis resulting from the severe financial problems in the thrift industry. Congress recognized that one cause of the great losses suffered by taxpayers was past reliance by thrifts on intangible assets of illusory value. A central feature of the reforms in FIRREA is thus the requirement that tangible capital of real

economic value replace substanceless intangibles in the finances of the Nation's thrift institutions. Contrary to petitioners' contentions (Pet. 15-17), Congress unambiguously expressed that requirement in the straightforward language of 12 U.S.C. 1464(t).

The court of appeals and OTS properly declined to read the largely ministerial savings provision of Section 401(g)(1) so as to subvert the unambiguous and universally worded substantive requirements of FIRREA. Section 401(g)(1) appears in Title IV of FIRREA, "Transfer of Functions, Personnel, and Property," and by its terms applies only to those matters affected by the abolition of the predecessor agencies. The treatment of supervisory goodwill in 12 U.S.C. 1464(t) is wholly unrelated to the fact that the Bank Board and FSLIC no longer exist.

In addition, although Section 401(g) does not address the continued applicability of the forbearances granted by FSLIC and the Bank Board, another provision of FIRREA does speak directly to that issue. Section 401(h) of FIRREA, 103 Stat. 357 (emphasis added), provides that

> all orders, resolutions, determinations, and regulations * * * issued, made, prescribed, or allowed to become effective by the [FSLIC] or the * * * Bank Board * * * [that] are in effect on the date this Act takes effect, shall continue in effect * * * *until modified, terminated, set aside, or superseded* in accordance with applicable law by the Director of [OTS or] the [FDIC] * * * or *by operation of law.*

Through this plain language, the dictates of FIRREA concerning the allowable use of supervisory goodwill, and the OTS Director's action pursuant to that mandate, supersede any prior regulatory waiver.

In short, the plain language of the statute, in full accord with the legislative history reviewed by the court of appeals (see Pet. App. 15a-17a) and the surrounding statutory framework (see *id.* at 14a), supports the OTS interpretation. See *id.* at 14a-17a. That demonstrably permissible interpretation is entitled to *Chevron* deference.

3. Petitioners purport to rely on the principle that a congressional intent to upset settled expectations must be stated in "clear, unambiguous and unmistakable terms." Pet. 15. Even if FIRREA were ambiguous and OTS's interpretation of FIRREA were not entitled to deference, however, petitioners' principle would have no application to this case.

First, the letter was not a contract, but rather a "regulatory decision" issued in the context of a pervasively regulated industry. See *National R.R. Passenger Corp.* v. *Atchison, Topeka & Santa Fe Ry.*, 470 U.S. 451, 465-470 (1985). The Bank Board merely granted a waiver of certain then-existing (albeit less rigorous) regulatory requirements; it did not thereby create any corresponding obligations or duties on the part of the government, and the modification of the capital requirements did not upset any reasonable, settled expectations.

Second, even if the Bank Board's forbearance letter were a contract, this Court has made clear that such contracts are subject to subsequent legislation and are to be construed so as to avoid foreclosing the exercise of sovereign authority. *Bowen* v. *Public Agencies Opposed to Social Sec. Entrapment*, 477 U.S. 41, 52-53 (1986). See also *North American Commercial Co.* v. *United States*, 171 U.S. 110, 137 (1898) ("governmental [regulatory] powers cannot be contracted away"). So construing the relevant documents involved here poses no difficulty. Indeed, section VIII(D) of the Vot-

ing and Disposition Rights/Dividend Agreement made clear that subsequent regulatory changes "may be made" and that such changes "may increase or decrease [their] obligation under this Agreement." Pet. App. 5a. Far from binding the federal government indefinitely to freeze the former regulatory requirements as applied to Franklin Federal, the documents that formed the alleged "contract" in this case thus put petitioners on ample notice that Franklin Federal would not be exempt from future regulatory changes.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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